

## **TABLE OF CONTENTS**

	PAGE
<b>EXECUTIVE SUMMARY</b> <a href="#">Click Here To View</a> .....	i
<b>INTRODUCTION</b> .....	1
<b>BACKGROUND</b> .....	2
<b>SCOPE AND METHODOLOGY</b> .....	2
<b>FINDING I</b> <b>IMPROVEMENTS ARE NEEDED FOR SOLE SOURCE AND</b> <b>STANDARDIZATION PURCHASES</b> .....	5
Sole Source And Standardization Purchases .....	6
Written Justifications For Most Sole Source And Standardization Purchases Are Not Prepared .....	8
There is No Formal Requirement That Long-Standing Standardization Purchaseing Arrangements Be Periodically Re-Examined .....	10
Price Negotiations With Sole Source And Standardization Vendors Are Not Documented .....	12
Procedures For Sole Source And Standarization Purchases Are Not Documented .....	13
<b>CONCLUSION</b> .....	15
<b>RECOMMENDATIONS</b> .....	15
<b>FINDING II</b> <b>THE CITY NEEDS TO DEVELOP ITS OWN</b> <b>PERFORMANCE CRITERIA FOR THE \$4 MILLION</b> <b>RADIO COMMUNICATIONS SYSTEM THAT WILL BE</b> <b>USED IN THE NEW COMMUNICATIONS CENTER</b> .....	18
The City's New Communications Center And New Communications System .....	19

Authoritative Purchasing Standards, The City's Municipal Code And Other Jurisdictions' Purchasing Practices .....	20
The City Did Not Develop Performance Specifications .....	21
The Vendor Is Developing The Acceptance Test Plan .....	22
The City May Pay More Than The Lowest Possible Price .....	23
The City May Accept A Communications System That Does Not Meet Its Needs .....	24
The Vendor Was Not Required To Post A Performance Bond.....	26
The City Needs To Develop Its Own Performance Criteria And Acceptance Test Plan .....	29
<b>CONCLUSION .....</b>	<b>30</b>
<b>RECOMMENDATIONS.....</b>	<b>30</b>
<b>ADMINISTRATION'S RESPONSE</b> <a href="#">Click Here To View</a> .....	<b>32</b>
<b>APPENDIX A</b> <a href="#">Click Here To View</a> <b>DEFINITIONS OF PRIORITY 1, 2, AND 3</b> <b>AUDIT RECOMMENDATIONS .....</b>	<b>A-1</b>
<b>APPENDIX B</b> <a href="#">Click Here To View</a> <b>CITY OF SAN DIEGO</b> <b>COMMUNICATIONS SYSTEM ACCEPTANCE TEST PLAN .....</b>	<b>B-1</b>

## **INTRODUCTION**

In accordance with the City Auditor's 1989-90 Audit Workplan, we have reviewed City-wide contracts relating to sole source and standardization purchases. We conducted this audit in accordance with generally accepted government auditing standards, and limited our work to those areas specified in the Scope and Methodology section of this report.

## BACKGROUND

The San Jose City Charter and the Municipal Code specify the contract authority and contracting requirements and procedures within the City government. Implicit in the charter and code sections dealing with City contracting are the goals of competition, fairness, economy, and openness. These goals are in keeping with authoritative standards of government purchasing.

*Definition of the purchasing function begins with a clear understanding of the fundamentals of public contracting. Chief among them are competition, impartiality, conservation of funds, and openness. Briefly translated, they mean that public business is to be offered for competition; that bidders are to be treated alike and contracts administered alike, without favoritism; that economy and value are basic aims; and that documents used and actions taken are public information. (The Council of State Governments and The National Association of State Purchasing Officials, State and Local Government Purchasing, 3rd ed., 1988 [SLGP], page 7.)*

To achieve these goals, the San Jose Municipal Code requires competitive bidding as the primary method for City procurement. However, there are circumstances when competitive purchases are not required. Recognizing such circumstances, the Municipal Code and authoritative government purchasing standards prescribe alternate methods of purchasing. These alternate methods place special burdens on the purchasing function to establish accountability and provide safeguards against abuse. This audit report focuses on the City's risks and controls relating to two purchasing methods recognized in the Municipal Code as exceptions to the City's bidding requirements: sole source and standardization purchases.

## **SCOPE AND METHODOLOGY**

This audit report is the first of a series of reports on City-wide Contract Management.

Our audit included a review of the Department of General Services' procedures relating to sole source and standardization purchases that were for more than \$5,000 but not more than \$20,000. We tested the documentation of sole source and standardization purchases that were made from July 1988 through March 1989 to determine if these purchases were adequately justified. In addition, we reviewed the contract and related justification for the standardization purchase of the City's new radio communications system.

We also compared the City's purchasing policies and procedures to authoritative government purchasing standards. These authoritative standards included those of the Council of State Governments, the National Association of State Purchasing Officials, and the Council of Urban, State and Local Government Law of the American Bar Association. Finally, we contacted purchasing staffs of other jurisdictions to see how their practices compared to San Jose's.

As a basis for our audit, we performed a risk assessment of City-wide contract management. The purpose of our risk assessment was to determine the potential for excessive costs or abusive practices arising from those risks that are inherent to contract management. We asked all of the City departments and offices with contracting responsibilities to provide input on inherent contracting risks and to identify existing controls and procedures

that are in place to mitigate those risks. We then verified and tested those controls and procedures which we determined to be the most important. Based on the results of our examination, we assessed the degree of effectiveness of the City's existing system of controls and procedures over contracting activities as it relates to sole source and standardized purchases. Finally, we recommended additional controls and enhancements that in our opinion will reduce the City's exposure to excessive costs and abusive practices and will improve the effectiveness and efficiency of City contract management. A subsequent City Auditor audit report will address sole source and standardized purchases greater than \$20,000.

# **FINDING I**

## **IMPROVEMENTS ARE NEEDED FOR SOLE SOURCE AND STANDARDIZATION PURCHASES**

Sole source and standardization purchases are intended to expedite the City's acquisition process by eliminating the need to subject purchases to a competitive bid process. Because sole source and standardization purchases, by definition, expose the City to certain inherent risks, the City's Municipal Code and authoritative purchasing standards prescribe under what circumstances sole source and standardization purchases should be used. Further, authoritative purchasing standards require that:

- ◆ Written justifications for sole source and standardization purchases should be prepared;
- ◆ Long-standing standardization purchasing arrangements should be periodically re-examined;
- ◆ Price negotiations with sole source and standardization vendors should be documented; and
- ◆ Procedures for sole source and standardization purchases should be documented.

Our review, however, revealed that the City is not generally adhering to the above standards for City-wide sole source and standardization purchases that were for more than \$5,000 but not more than \$20,000. As a result, the City is exposed to the risk of 1) stifling competition, 2) favoring certain vendors, and 3) paying more than the lowest possible price for the estimated \$700,000 per year in City-wide \$5,000 to \$20,000 sole source and standardization purchases.

## **Sole Source And Standardization Purchases**

The San Jose Municipal Code and authoritative purchasing standards prescribe under what circumstances sole source and standardization purchases should be used.

According to National Association of State Purchasing Officials standards and the Council of Urban, State and Local Government Law (American Bar Association), competitive sealed bidding is the preferred method of government procurement. Sole source and standardization purchases are looked upon as exceptions that should be justified and documented. According to the National Association of State Purchasing Officials:

*Merely citing a condition for waiver, without supporting information and justification, is not adequate reason for documentation. (State and Local Government Purchasing [SLGP], page 68.)*

The San Jose Municipal Code also recognizes competitive bidding as the City's primary procurement method. The Code does, however, allow sole source procurement by listing it as one of the conditions under which the City's bidding requirement does not apply. Section 4.12.020 states, in part:

*"Purchases of supplies, materials and equipment shall be in accordance with bidding requirements provided in the city charter and in this chapter. Bidding requirements shall not apply in any of the following:*

*.... D. The purchase of any supplies, materials or equipment which can be obtained from only one vendor or manufacturer."*



The San Jose Municipal Code also allows standardization purchases, but only under specified circumstances. Section 4.12.149 states:

*“Where the director of general services has determined that it is required by the health, safety or welfare of the people or employees of the city or that significant costs savings have been demonstrated, standardization of supplies, materials or equipment is permitted and the specifications may limit the purchase to a single brand or trade name. Among the factors that may be considered in determining to standardize on a single brand or trade name are that: (A) Repair and maintenance costs would be minimized; (B) User personnel training would be facilitated thereby; (C) Supplies or spare parts would be minimized; (D) Modifications to existing equipment would not be necessary; (E) Training of repair and maintenance personnel would be minimized; (F) Matching existing supplies, materials or equipment is required for proper operation of a function or program.”*

The Model Procurement Code - Recommended Regulations (MPC) of the Council of Urban, State and Local Government Law recommends the following as conditions for the use of sole source procurement:

*“Sole source procurement is not permissible unless a requirement is available from only a single supplier. A requirement for a particular proprietary item does not justify a sole source procurement if there is more than one potential bidder or offeror for that item. The following are examples of circumstances which could necessitate sole source procurement:*

- (a) where the compatibility of equipment, accessories, or replacement parts is the paramount consideration;*
- (b) where a sole supplier’s item is needed for trial use or testing;*
- (c) where a sole supplier’s item is to be purchased for resale;*
- (d) where public utility services are to be procured.*

*The determination as to whether a procurement shall be made as a sole source shall be made by the Chief Procurement Officer, the head of a Purchasing Agency, or designee of such officer. Such determination and the basis therefore shall be in writing. Such*

*officer may specify the application of such determination and the duration of its effectiveness. In cases of reasonable doubt, competition should be solicited. Any request by a Using Agency that a procurement be restricted to one potential contractor shall be accompanied by an explanation as to why no other will be suitable or acceptable to meet the need. (Emphasis added) (MPC-Recommended Regulations, page 49.)”*

The National Association of State Purchasing Officials, State and Local Government Purchasing, also has the following comments and recommendations regarding standardization purchases:

*“The brand name specification (i.e., standardization) or a detailed specification which is written to have the effect of limiting the bidding to a single product are the most restrictive kinds of specifications. Their use should not be permitted unless only one product will meet an intended need, and the chief purchasing official has made a prior written determination to this effect. And even where product competition has to be denied, price competition should be solicited to the extent possible. (Emphasis added) (SLGP, page 44.)”*

From the foregoing, it is clear that the San Jose Municipal Code and authoritative purchasing standards recognize sole source and standardization purchases as legitimate and useful purchasing methods. However, authoritative purchasing standards caution purchasing officials regarding the inherent risks for those purchases, and emphasize the need to justify such purchases in writing.

### **Written Justifications For Most Sole Source And Standardization Purchases Are Not Prepared**

We tested the documentation for sole source and standardization purchases made during 1988-89 to determine if such purchases were adequately justified. Our test revealed that only two of the eighteen sole

source and standardization purchases we reviewed included a written justification for the method of purchase selected.

Authoritative purchasing standards require written justification for each major purchase necessitating a waiver of competition. Sole source and standardization purchases are examples of purchases necessitating a waiver of competition.

*“The rule or regulation should state that although there is provision for waiver, competition is required wherever practicable and, except where it applies to small purchases, the basis and reasons for each waiver shall be documented as a public record. (SLGP, page 68.)”*

Additionally, we noted in one of the eighteen purchases we reviewed that Purchasing had to make a sole source purchase for modular exhibits because the requesting department had dealt extensively with the vendor in preparing the specifications prior to contacting Purchasing. According to authoritative literature, such vendor involvement is inappropriate. For example, the State and Local Government Purchasing Manual states that:

*“There is often direct vendor involvement in the development of specifications by using agencies. This condition emphasizes further that although using agencies may initiate the descriptions of items they are seeking, it must remain the responsibility of central purchasing to determine that a specification which finally accompanies the Request for Bids is not unnecessarily restrictive...(SLGP, page 43.)”*

The manual further recommends that:

*“Rules or regulations to implement the (purchasing) statute should prohibit material furnishers and prospective suppliers from bidding on requirements if they prepare or assist in preparing the specifications. (SLGP, page 42.)”*

Section 202.2 of the City's Administrative Manual establishes the City's basic purchasing policy. However, Section 202.2 does not contain language that explicitly prohibits materials furnishers and prospective suppliers from bidding on City purchases if they prepared or assisted in the preparation of the bid specifications.

Based upon our review, it is our opinion that General Services should set a policy that requires written justifications for each sole source and standardization purchase. Further, General Services should initiate the amending of the City's Administrative Manual to explicitly prohibit material furnishers and prospective suppliers from bidding on City purchases if they prepared or assisted in the preparation of the bid specifications.

**There Is No Formal Requirement That Long-Standing  
Standardization Purchasing Arrangements  
Be Periodically Re-Examined**

Recognizing the risks imposed by outdated purchasing standard specifications, the National Association of State Purchasing Officials recommend that purchasing standard specifications be periodically re-examined. For example, the Association states that:

*"An accelerated rate of technological change tends to impose a built-in obsolescence on standard specifications for many kinds of items. The programs should not be abandoned, however, or allowed to languish -- there is still a need for them. But if they are to be assets instead of handicaps, they need to be re-evaluated and modified.*

*Re-examination should be directed to the end that the program accommodates and is readily responsive to new concepts, to improved products, and to advanced applications. This calls for focus on at least five aspects of the program:*

- (a) *Identifying items for which standards currently are relatively stable.*
- (b) *Discontinuing standard specifications for items where such specifications are no longer needed or it has become impractical to update and maintain them.*
- (c) *Substituting, wherever possible, performance requirements for dimensional and other design-type details, especially on items for which manufacturing standards tend to be unstable.*
- (d) *Providing a highly expeditious means of reviewing and modifying a standard specification for a current procurement.*
- (e) *Expanding the advisory role and ad hoc participation of using agency personnel throughout the standards work.*

*A standardization and standard specifications program, as popularly conceived and operated, is a static program in terms of the daily scientific advances and unpredictable markets that have become commonplace. The ability of such a program to meet its fundamental objectives, yet adjust and be current, depends upon flexibility both in procedure and in specifications writing. As a means of reducing rigidity and obsolescence for items that must be custom-made or unique, standard specifications may emphasize details, but should incorporate performance standards where practicable. For commercially available items, a standard specification should be based on performance criteria with design/detailed factors used only if demanded. (SLGP, page 47.)*

However, our review revealed that the City is not re-examining its justifications for standardization purchases. In fact, we noted an example where the City has purchased millions of dollars of communications equipment exclusively from the same vendor for several years. These standardization purchases were based upon a decision that General Services made in 1984. General Services has not revisited its 1984 decision in spite of the significant dollars involved and the dynamic nature of the communications industry.

The City should periodically re-examine its standardization purchases to ensure that the justifications for such purchases reflect the City's current needs and advances in product technologies.

### **Price Negotiations With Sole Source And Standardization Vendors Are Not Documented**

Our review of sole source and standardization purchases disclosed that General Services does not document its price negotiations with sole source and standardization vendors. Of the 18 purchases included in our sample, none showed a record of the steps the Department's buyer took to obtain the best price and purchase terms available.

The National Association of State Purchasing Officials offers the following comments and recommendations regarding negotiation for sole source and standardization purchases:

*"In its broadest sense, negotiation occurs in making any purchase. Noncompetitive purchases, however, imply a need for conducting a definite form of negotiation, and with few exceptions, e.g., very small purchases, this should be required by statute and rules.*

*In preparing for noncompetitive negotiation, the purchaser should make a list of specific objectives relating to price, delivery, performance standards, warranty, and contractual terms and conditions. This is particularly necessary for sole source purchases where the purchaser's bargaining position is weakened by the lack of alternatives normally afforded by competition. To compensate for this absence, the purchaser needs to make the business attractive to the seller and display good faith at all times, but to rely on withholding the business, if possible, in the face of any unreasonable demands on the part of the seller. These guidelines apply whether the negotiations are conducted in person or by correspondence or telephone.*

*Whatever the manner and outcome, the negotiation should be supported by adequate documentation. Rules governing the confidentiality of data and proprietary information should be observed. (Emphasis added)*

*For a brand-name, exclusive specification, rules should require that central purchasing determine in writing that the purchase be restricted to one brand. The rule should further stipulate that where the product is available from more than one source, price competition be solicited. If price competition cannot be obtained, purchase is made through written quotation and/or negotiation with the single source. (Emphasis added) (SLGP, page 48.)”*

According to General Services, the City’s buyers negotiate and analyze costs and prices of sole source purchases. The buyers do this by a) calling other jurisdictions regarding their experience with the item; b) comparing prices of similar products; c) researching past prices that the City paid; or d) directly negotiating price discounts, trade-ins, and other concessions with the sole source vendor. In our opinion, General Services should require its buyers to record which of the above steps they took in negotiating for the best price and terms for the City. Such documentation should be filed as part of the documentation for sole source and standardization purchases.

### **Procedures For Sole Source And Standardization Purchases Are Not Documented**

Internal control standards require that internal control systems be clearly documented. Such documentation includes the identification of internal control objectives, techniques, and accountability systems. Our review revealed that General Services has not adequately documented its internal controls relating to sole source and standardization purchases. As a result, Purchasing staff may not understand or properly implement these controls.

Internal control standards, as defined by the U.S. General Accounting Office, state that:

*“Internal control systems and all transactions and other significant events are to be clearly documented and the documentation is to be readily available for examination.*

*This standard requires written evidence of 1) an agency’s internal control objectives and techniques and accountability systems and 2) all pertinent aspects of transactions and other significant events of an agency. Also, the documentation must be available as well as easily accessible for examination.”*

Our review revealed that General Services has not adequately documented its internal controls relating to sole source and standardization purchases. Specifically, the internal controls that need to be documented include the procedures for:

- Identifying and classifying sole source and standardization purchases;
- Documenting the justification for sole source and standardization purchases; and
- Documenting price negotiations for sole source and standardization purchases.

Internal control documentation is a tool to help assure that internal controls are understood and followed and that management’s policies are implemented. In addition, internal control documentation facilitates staff training, standardizing and measuring employee productivity, and preserving valuable institutional information that veteran employees possess.



## **CONCLUSION**

Authoritative purchasing standards require that:

- Written justifications for sole source and standardization purchases should be prepared;
- Long-standing standardization purchasing arrangements should be periodically re-examined;
- Price negotiations with sole source and standardization vendors should be documented; and
- Procedures for sole source and standardization purchases should be documented.

Our review, however, revealed that the City is not generally adhering to the above standards for City-wide sole source and standardization purchases that were for more than \$5,000 but less than \$20,000. As a result, the City is exposed to the risk of 1) stifling competition, 2) favoring certain vendors, and 3) paying more than the lowest possible price for the estimated \$700,000 per year in City-wide \$5,000 to \$20,000 sole source and standardization purchases.

## **RECOMMENDATIONS**

We recommend that the General Services Department:

### **Recommendation #1:**

Set a policy requiring a written justification for each sole source and standardization purchase. (Priority 2)

**Recommendation #2:**

Initiate amending Section 202.2 of the City's Administrative Manual to explicitly prohibit prospective vendors and suppliers from bidding on purchases if they prepared or assisted in preparing the bid specifications. (Priority 2)

**Recommendation #3:**

Periodically re-examine the City's standardization purchases to ensure that the justification for such purchases reflect changes in the City's needs and current advances in product technologies. (Priority 2)

**Recommendation #4:**

Require the City's buyers to prepare and maintain a permanent record of what steps they took when negotiating with vendors for purchase prices and terms for sole source and standardization purchases. (Priority 2)

**Recommendation #5:**

Document the City's internal controls relating to sole source and standardization purchases. Specifically, General Services should document the City's procedures for:

- Identifying and classifying sole source and standardization purchases;
- Documenting the justification for sole source and standardization purchases; and

- Documenting price negotiations for sole source and standardization purchases. (Priority 3)

**Recommendation #6:**

Prepare an analysis of staff needed to implement recommendations #1 through #5 of this report and incorporate those needs into its proposed budget for 1990-91. (Priority 2)

## **FINDING II**

### **THE CITY NEEDS TO DEVELOP ITS OWN PERFORMANCE CRITERIA FOR THE \$4 MILLION RADIO COMMUNICATIONS SYSTEM THAT WILL BE USED IN THE NEW COMMUNICATIONS CENTER**

In October, 1990, the City of San Jose will open its new Communications Center. An essential part of the new Communications Center is the radio communications system that the City has contracted to purchase for about \$4 million. For such a large and sophisticated acquisition, authoritative purchasing standards and other jurisdictions' purchasing practices prescribe that the City should have competitively bid the purchase, developed performance specifications, and prepared an acceptance test plan. However, our review of the City's acquisition of the communications system for the communications center revealed that:

- ◆ the City has not developed performance specifications for its communications equipment;
- ◆ the vendor, not the City, is developing the Acceptance Test Plan for the communications system; and
- ◆ the City did not require the vendor to post a performance bond.

As a result, the City is exposed to the risk of paying more than the lowest possible price for the Communications Center's communications system and accepting a communications system that will not meet the City's communications needs. By developing its own performance criteria, the City will have added assurance that its new \$4 million radio communications system will meet its needs.

## **The City's New Communications Center And New Communications System**

In October, 1990, the City of San Jose will open its new Communications Center. A brief history of the City's decision to acquire its own communications capability is contained in a City consultant's report, Public Safety Radio Dispatch System Design, issued in April, 1989:

The City of San Jose, California entered into an agreement with the County of Santa Clara on September 3, 1974 to transfer all City emergency dispatching equipment and funds to the County in return for the County's provision of dispatching services to City agencies. The County's Communications Center has been providing communications services through a network of leased telephone lines and radio sites since that time. However, in October, 1980, as funding sources became scarce due to legislative cut-backs, the County decided that a new agreement must be ratified by June 30, 1985, or the County would cease providing the dispatching services.

To determine a course of action, the City hired a consulting firm to analyze the City dispatching needs and requirements. A March 1984 report entitled Emergency Communications Study, Final Report provided findings and recommendations that allowed the City to decide to withdraw from the County center as soon as the City has established its own capabilities. (City of San Jose Public Safety Radio Dispatch System Design Report, 4/18/89, Chapter I - Introduction.)

An essential part of the City's new Communications Center is the radio communications system that the City has contracted to purchase for about \$4 million. The new communications system includes the system equipment, equipment installation, data services, program management, training, and various system options. The City did not competitively bid the \$4 million contract. Instead, the City let this \$4 million purchase to the equipment manufacturer as a standardization purchase largely based on a General Services determination that was made in 1984.

**Authoritative Purchasing Standards,  
The City's Municipal Code And Other  
Jurisdictions' Purchasing Practices**

Authoritative purchasing standards and other jurisdictions' purchasing practices prescribe that the City should have competitively bid the \$4 million purchase of the City's new communications system.

Authoritative purchasing standards support the requirement for strict justification of brand name standardization:

The brand name specification (i.e., standardization) or a detailed specification which is written to have the effect of limiting the bidding to a single product are the most restrictive kinds of specifications. Their use should not be permitted unless only one product will meet an intended need, and the chief purchasing official has made a prior written determination to this effect. (SLGP, page 44.)

The San Jose Municipal Code Section 4.12.149 specifies that standardization on a single brand is permitted; however, certain conditions must exist:

Where the director of general services has determined that it is required by the health, safety or welfare of the people or employees of the city or that significant costs savings have been demonstrated, standardization of supplies, materials or equipment is permitted and the specifications may limit the purchase to a single brand or trade name. (SJMC Section 4.12.149.)

Our review revealed that General Services justified the standardized purchase for the City's new communications system largely based upon a 1984 determination. In addition, General Services has not formally re-examined its 1984 determination to determine if changes in the City's communications needs or changes in the communications industry make the

opening of competition in the City's communications equipment purchases feasible and/or desirable. In our opinion, because General Services has not formally re-examined its standardization policy for communications equipment, it has not adequately justified the waiver of a competitive bid for the purchase of the new communications center's equipment.

Furthermore, other jurisdictions do not consider brand name standardization of communications equipment to be advantageous. According to purchasing and communications staffs in Cities of San Diego, California and Sacramento, California, and the State of California, they competitively bid major communications equipment purchases. They are able to bid their communications purchases by standardizing on performance specifications rather than on brand name.

### **The City Did Not Develop Performance Specifications**

Authoritative purchasing standards recommend the use of performance specifications:

An accelerated rate of technological change tends to impose a built-in obsolescence on standard specifications. ... Re-examination should be directed to the end that the program accommodates and is readily responsive to new concepts, to improved products, and to advanced applications. This calls for ... substituting, wherever possible, performance requirements for dimensional and other design-type details, especially on items for which manufacturing standards tend to be unstable. (Emphasis added) (SLGP page 47.)

Performance specifications retain the advantage of brand name specification in ensuring the level of desired quality of merchandise purchased while at the same time make competitive bidding feasible. The National Association

of State Purchasing Officials observes that an increasing number of jurisdictions are using performance specifications:

The popularity of the functional or performance type of specification has grown rapidly in recent years. The terms “functional” and “performance” are used interchangeably to designate an approach to specifications that is less interested in dimensions and materials and configurations and more interested in what a product does. The performance specification is less concerned as to how a product is made, and more concerned as to how well it performs, and at what cost. Performance purchasing is results-oriented in terms of function and cost. In contrast to the design approach, performance specifications afford the manufacturer or bidder sizable latitude in how to accomplish the end purpose... Performance requirements describe the characteristics and capabilities that are pertinent to the intended use of the article. (SLGP page 45.)

Because the City has chosen to use brand name specification for communications equipment, the City has not been able to develop performance specifications that would have made competitive bidding feasible. As a result, the City may have lost an opportunity to save on communications equipment costs. In our opinion, General Services should develop performance specifications for communications equipment to enable the City to competitively bid communications equipment purchases.

### **The Vendor Is Developing The Acceptance Test Plan**

Because the City did not develop performance specifications for its \$4 million communications system, it cannot independently prepare an Acceptance Test Plan (ATP) for the system. Instead, the vendor will prepare the ATP. Specifically, the City’s contract with the vendor calls for the vendor to submit its proposed ATP 30 days prior to the commencement of the system test. The City is then allowed only 15 days to review it.



(Vendor) will submit a proposed Acceptance Test Plan (“ATP”), which demonstrates System performance in accordance with the specifications contained herein, thirty (30) days prior to the commencement of the System test. The CITY will then have fifteen (15) days from the date of receipt of the proposed ATP within which to approve, conditionally approve or disapprove in writing the proposed ATP. Approval of the proposed ATP will be assumed by (vendor) in the absence of notification otherwise. The successful completion of the Acceptance Test Procedure will be the sole criterion for System acceptance, and final acceptance shall be confirmed in writing within thirty (30) days of successful completion of the testing. (City contract for purchase of Radio Communications System, 9/13/89, Section 5-A)

Because the contract allows the vendor to develop the ATP and to submit it only after the vendor has installed the equipment, the City is exposed to the risk that the vendor may intentionally design the tests to show only what the installed equipment can do rather than to show how the City’s communications needs are being met. Obviously, because the vendor has vested interest in the City accepting its equipment, any ATP the vendor designs could have a bias toward encouraging City acceptance.

### **The City May Pay More Than The Lowest Possible Price**

During our survey of other governmental purchasing jurisdictions, purchasing staff for the City of Sacramento, California, related to us how competitively bidding their purchases actually resulted in the City paying substantially lower prices. Furthermore, the City of Sacramento accomplished these savings without sacrificing on the level of equipment performance or quality.

Additionally, the City of San Diego, California, and the State of California have also opened their communications equipment purchases to competition. Staffs from these jurisdictions also expressed satisfaction with

the competitive bidding process for communications equipment. In addition, San Diego is currently preparing a Request for Proposal package for a major communications system project. San Diego plans to contact various communications equipment manufacturers that may wish to compete for the project.

Based upon our discussions with officials from the Cities of Sacramento, California, and San Diego, California, and the State of California, it appears that the City of San Jose could have competitively bid its purchase of communications equipment for the communications center.

### **The City May Accept A Communications System That Does Not Meet Its Needs**

In its 1984 memorandum justifying the standardization on one brand of communications equipment, General Services cited accessory compatibility as one of the major reasons for standardizing. This need for compatibility was reiterated in the February 28, 1989 memorandum General Services sent to the City Council, requesting approval of a standardized purchase for the communications system:

San Jose's Communications Project is a highly complex project involving not only a new building, but also a new radio system, a new Computer-Aided Dispatch system, a new 9-1-1 answering point, and a new organization of approximately 200 people. All of these elements must function together reliably in October, 1990.

Thus, it is essential that the new communications equipment be able to perform with other products that other vendors will supply for the new Communications Center. For example, one contract is for the Computer-

Aided Dispatch (CAD) System mentioned above. The primary purpose of the CAD system is to assist dispatchers in handling emergency calls for service. In a March 10, 1989 memorandum to the City Council, the Director of General Services describes the interface requirements of the CAD system:

The CAD system requires interfaces to many external computerized systems such as ... mobile digital terminals (MDTs) located in Police and Fire units. These interfaces require the CAD system to process queries and messages which must be routed quickly and accurately to the appropriate personnel.

Sections 2.0 and 3.5.1 of the proposal for the communications system equipment also described the importance of the interface between the communications equipment and the CAD system:

The MOBILE DATA TERMINAL SYSTEM will be an expansion of the system that is currently being used by the San Jose Police Department. This system will interface with the CAD System that is being purchased from another vendor. The combined system will provide inbound and outbound message functions, as well as direct in-vehicle access to the City's own data base and Public Safety networks such as CLETS and NCIC. ... The CAD system at the Communications Center will signal the fire stations through (the vendor's) Smart Status computer interfaced to an MSR 2000 base station. This is accomplished by MDC 1200 digital signalling. This signal will be received by radio units equipped with digital decoders which will be placed in cabinets located in the fire stations. Upon reception of the proper code sequence the decoders will activate a relay which will be used to drive the City-provided alerting functions.

Because of the interface requirements of the CAD and communications equipment systems, it is essential that the communications equipment be compatible with the CAD system. However, because of the wording in the City's contract with the vendor for the communications equipment, such compatibility is not guaranteed. Exhibit A, Section 11 of the \$4 million communications system contract states:

This agreement does not extend to the performance of the equipment as a part of a larger system generally nor specifically to equipment in combination with products, elements or components not supplied by (vendor).

Because the vendor does not guarantee larger-system compatibility, the City is subject to the risk that its new \$4 million communications system will not satisfy the City's requirement for system interface with products that other vendors supply.

### **The Vendor Was Not Required To Post A Performance Bond**

In spite of Code requirements and authoritative standards, the City's contract for the new communications system does not require the vendor to post a performance bond (or an equivalent security) to ensure faithful performance on the contract.

San Jose Municipal Code Section 4.12.070 states:

"To secure faithful performance of the contract, the director of general services is authorized to require security in the form of cash, cashier's check, certified checks, or corporate faithful performance bonds, in such amount as he shall deem reasonably necessary to protect the best interests of the city. The director of general services need not require such security if he does not deem such to be reasonably necessary to protect the best interest of the city, or if he believes the interests of the city are best served by not requiring the same."

In addition, the State and Local Government Purchasing Manual describes the protection provided by performance bonds:

"Requiring bonds as a part of the bidding and award process, and as applicable until completion of a contract, is intended as protection for the taxpayer against bad faith or failure on the part of bidders and contractors. ... Performance bonds are invariably required for public works contracts

and not infrequently on contracts for equipment and services. The bonds are furnished by a properly licensed surety company and provide for fulfillment of the contract obligations by others in the event of default by the successful bidder. As with payment bonds, the amount of a performance bond is usually 100 percent of the amount of the contract and may be reduced proportionately as performance under the contract moves forward successfully. A different form of protection, and one which can reduce costs to the successful bidder and the purchaser, is to allow the contractor to post a certificate of deposit or letter of credit payable to the jurisdiction and on which he collects interest if the contract is performed satisfactorily. (SLGP page 56.)”

In spite of Code requirements and authoritative standards, the City of San Jose waived the requirement for a performance bond on its \$4 million communications contract. According to the Director of General Services, the decision to waive the performance bond requirement was based on the complexity of the total communications center project and on the inability of the City to pinpoint responsibility among the various contractors involved should the project fail. In addition, because the equipment purchased is the “latest state-of-the-art”, General Services does not think that the City would have another manufacturer to turn to should the vendor not be able to perform. In lieu of a performance bond, the City included a “liquidated damages” provision to induce the vendor to complete the contract on time. Section 4F of the contract provides that the vendor “*shall pay the City liquidated damages of \$850 for every day the System has not obtained substantial completion. Said payments are not to exceed \$1,000,000.*”

Because the City has not developed its own performance criteria and because proposals from other manufacturers were not obtained, the City cannot be certain that no other manufacturer can meet the City’s communications equipment needs. With regard to the “liquidated damages” provision, such a provision may give the vendor an incentive to perform on

time. However, the \$1 million limit on the liquidated damages may not provide sufficient protection to the City, given that the total contract amount is for \$4 million. Further, with regard to the City's inability to pinpoint responsibility for failure among the various contractors, the City should be able to overcome such inability by carefully monitoring the system's installation and conducting comprehensive tests of the system's components.

It should be noted that the City of San Diego, California, is considering the requirement of a performance bond in a \$8 to \$10 million contract for purchasing a major communications system. The City of San Diego has included in its bid specifications for its communications project that *"the successful bidder may be required to furnish the City with a surety bond conditioned upon the faithful performance of the contract."*

Finally, it should be noted that General Services did not ask the City's Risk Manager to review the decision to waive the performance bond requirement. In our opinion, the City's Risk Manager should review waiver of performance bonds on major purchasing contracts. This would appear to be in keeping with the Risk Manager's role to review contracts and major purchase orders to ensure that liability associated with contracted services or purchased goods are borne by the contractors and vendors.

### **The City Needs To Develop Its Own Performance Criteria And Acceptance Test Plan**

The City's contract for its new communications system allows the City only 15 days from the receipt of the vendor-proposed Acceptance Test Plan to approve, conditionally approve or disapprove in writing the vendor-

proposed Acceptance Test Plan. The contract further provides that “*the successful completion of the Acceptance Test Procedure will be the sole criterion for System acceptance.*”

Because the results of the Acceptance Test Procedure will be the sole criterion for System acceptance, it is critical that the City

- a) determine system performance criteria based on the City’s needs as soon as possible, and
- b) prepare a minimum set of tests that will determine whether the System being purchased meets the performance criteria identified (An example of a minimum set of tests is shown in Appendix B-1 of this report.)

Without such prepared performance criteria and a minimum set of tests, the City may not be able to judiciously review the vendor-proposed Acceptance Test Plan within the contract-imposed 15-day limitation.

## **CONCLUSION**

Our review of the City's acquisition of its \$4 million communications system for the new communications center revealed that:

- ◆ the City has not developed performance specifications for its communications equipment;
- ◆ the vendor, not the City, is developing the Acceptance Test Plan for the communications system; and
- ◆ the City did not require the vendor to post a performance bond.

As a result, the City is exposed to the risk of paying more than the lowest possible price for the Communications Center's communications system and accepting a communications system that will not meet the City's communications needs. By developing its own Acceptance Test Plan or performance criteria, the City will have added assurance of accepting a communications system that will meet the City's communications needs.

## **RECOMMENDATIONS**

We recommend that the General Services Department:

### **Recommendation #7:**

Re-examine and re-document the justification for on-going standardization purchases of communications equipment. (Priority 2)



**Recommendation #8:**

Develop performance specifications for communications equipment to enable the City to competitively bid communications equipment purchases should the Department conclude that competitive bidding is feasible.  
(Priority 2)

**Recommendation #9:**

Establish a policy requiring that the City's Risk Manager review every waiver of performance bond requirements for purchasing contracts in excess of \$50,000. (Priority 2)

**Recommendation #10:**

Preparatory to receiving the vendor's proposed Acceptance Test Plan for the new \$4 million radio communications system, determine the system's performance criteria based on the City's needs, and establish a minimum set of tests to determine if the new system meets the City's performance criteria.  
(Priority 2)

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